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DEPARTMENT FOR EUR DAS MERKEL AND EUR/CE JAMIE LAMORE

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TAGS: [PREL](#) [PGOV](#) [ENGR](#) [HU](#)
SUBJECT: DAS MERKEL SCENESETTER FOR BUDAPEST

Classified By: Pol/Econ Counselor Eric Gaudiosi; reasons 1.4 (b and d)

1. (SBU) Welcome to Budapest. Your visit comes as the Hungarian Government slowly re-engages following the long summer "cucumber season" and offers an excellent opportunity for discussion of Georgia, energy security and the way forward on relations with Russia. While Hungary remains a committed partner in the trans-Atlantic relationship - providing forces in Afghanistan, Iraq, and Kosovo - its economic problems, reform fatigue and sharp political divisions have resulted in gridlock, while its Russian energy dependence limits its ability to engage in foreign affairs. Prime Minister Gyurcsany is on the defensive personally and politically: the opposition (Fidesz) continues to press him on all fronts, and he is increasingly embattled and isolated even within his own socialist party (MSzP). With the dissolution of the MSzP-Free Democrats (SzDSz) coalition last spring, the Government is now feeling its way forward without a Parliamentary majority and faces its most important test of survival this fall when it presents the annual budget. As a minority Government, its major preoccupation will be remaining in power until the 2010 elections.

2. (C) Foreign policy issues remain largely fire-walled from the domestic political tension, with consensus holding on Hungary's engagement in Afghanistan - despite the recent deaths of two bomb disposal troops in Baghlan Province - and its recognition of Kosovo. That said, Georgia has opened a sharp rhetorical rift between the Government's moderate response (the Prime Minister commented publicly for the first time on September 1; the Foreign Minister has stuck tightly to the EU-NATO statements) and Fidesz's strong condemnation of Russian activities (which has engendered sharp attacks by the Russian Ambassador here). Fidesz has also called on the Government to suspend negotiations on the South Stream project. On Russia, throughout the course of recent briefings, GoH officials have changed their tune slightly with regard to Hungary's Russia policy. Increasingly, their approach appears to be one which admits Hungary's economic interest in expanding business relations but which underscores Budapest's enduring commitment to the West. This attempt to distinguish between business partners and strategic allies represents a new approach but not necessarily a real change, especially when the traded commodity is energy. Although Medvedev's comments regarding a "privileged sphere of interest" should help focus the GoH on the strategic challenge we face, ultimately, only Hungary's actions will demonstrate whether this is a rhetorical or a practical shift in its policy.

3. (C) For Hungary, energy security remains a crucial issue. Your schedule begins with the Director of Strategy for MOL (Hungarian Gas Company) Laszlo Varro. Over the past two years, we have focused on positive outreach to the GOH and MOL, offering assistance whenever possible. However, with the GOH seemingly looking first to Moscow (and second to Brussels) on energy issues, and with MOL promoting Gazprom-centric projects over Nabucco, we have adopted a more

cautious approach in recent months.

14. (C) Varro likely will assure you of MOL's commitment to energy diversification, but we also know that MOL has been offered access to sought-after fields in Russia if Nabucco is undermined. Similarly, Austria's OMV recently dropped a hostile takeover bid for MOL, but rumors of a Russian role in the attempt continue to fuel concerns that Gazprom has its sights set on key energy infrastructure assets. With the right offer - and the removal of the rival OMV middleman - MOL may find a Russian offer difficult to resist. Your visit provides an opportunity to press Varro on his views vis-a-vis Nabucco, South Stream and MOL's relationship with Gazprom.

15. (SBU) Following the meeting with MOL you will have a joint meeting with the Chairman of the Foreign Affairs Committee, Zsolt Nemeth, and the Chairman of the European Affairs Committee, Matyas Eorsi. Nemeth is a member of the opposition Fidesz party and he is outspoken in his criticism of the Government's response to Russia's actions in Georgia. He and several members of his committee will travel to the U.S. the week of September 15 for meetings at the Department, to include one with you, and at the NSC. Eorsi, a member of the SzDSz, went to Georgia a week after the Russian intervention and provided public criticism of Russia in a follow-on press conference as well as an article in a Hungarian weekly.

16. (C) At the Foreign Ministry you will meet Political State Secretary Gabor Szentivanyi and Gyorgy Giljan, State Secretary responsible for Russia - and reportedly their next Ambassador to Moscow. Your trip is an important signal of our responsiveness to their repeated desire for more consultations to avoid "misunderstandings," and an excellent opportunity to convey the depth and breadth of our concerns regarding recent developments vis-a-vis Russia. In a meeting with Ambassador Foley in July, Giljan began his overview of Hungary's Russia policy with the frank statement that "our focus is on implementing our interests - especially those of our business community." Exports to Russia have increased seven-fold within the past five years, now representing six percent of Hungary's total export volume with an estimated value of USD 3 billion. But Hungary's trade deficit remains enormous given its energy dependence on Russia. Russia supplies over eighty percent of Hungary's gas, providing opportunities for both subtle and blatant influence on Hungarian policy. The way forward on South Stream (SS) is a particular concern, especially following the events in Georgia, and we need to question their decision to continue South Stream negotiations in light of the recent Russian-Georgia conflict. Russian actions in Georgia undermine the GOH's characterization of the GOR as a "reliable partner," Budapest's favorite fall back in explaining its unwillingness to oppose Moscow on energy decisions. Szentivanyi was typically cautious in meeting with Ambassador Foley in July, outlining Hungary's commitment to continued engagement in Afghanistan and the Balkans but avoiding definitive commitments on NATO enlargement.

Although he stated that Hungary believes in "no Russian vetoes," he hastened to add that Budapest must "recognize that this is a consensual decision" for the Alliance. In principle, they support Membership Action Plans for both Georgia and Ukraine, but from a foreign policy perspective their stronger political and geographic ties to Ukraine make an invitation to Kyiv more important. The Foreign Minister has publicly supported the sovereignty and territorial integrity of Georgia but believes communication with Russia must be maintained.

17. (C) Your meeting with the Prime Minister's Foreign Policy Advisor, Karoly Banai, offers an opportunity to address the Hungarian/Russian relationship, in particular the South Stream project. In an August 26 meeting with the Ambassador, Banai commented that despite political difficulties associated with Georgia, the GOH would still like to develop economic relations not linked to politics. Banai stated they are still working on SS negotiations but he has "serious

doubts" about any declaration on SS or signing any agreement this year. Still, given this administration's historic lack of transparency on energy negotiations, we are concerned that Hungary is currently negotiating a more substantive South Stream contract, which could include murky intermediary companies. Finance Minister Janos Veres continues to lead South Stream negotiations for Hungary.

¶18. (C) Meanwhile, the Government has shown much movement but little progress on Nabucco. The appointment of Nabucco Ambassador Mihaly Bayer seems to have been aimed largely at appeasing Washington and, to a lesser extent, Brussels. To that end, Bayer has been charged with organizing a Nabucco summit to be held in Budapest in early 2009 but has not been empowered with more strategic decision-making authority. The GOH should be encouraged to do more - concluding, for example, a purchase agreement with a Central Asian supplier.

¶19. (SBU) We have scheduled press availability with one of the Hungarian daily newspapers.

¶10. (SBU) Ambassador Foley will host a dinner on Wednesday evening with members of the Prime Minister's Foreign Policy Advisory Board to hear their views on energy as well as other foreign policy issues.

¶11. (U) We look forward to welcoming you in person.
Foley